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RUEHUJA/AMEMBASSY ABUJA 1793
RUEHAR/AMEMBASSY ACCRA 1686
RUEHDS/AMEMBASSY ADDIS ABABA 1816
RUEHBY/AMEMBASSY CANBERRA 1093
RUEHDK/AMEMBASSY DAKAR 1450
RUEHKM/AMEMBASSY KAMPALA 1872
RUEHNR/AMEMBASSY NAIROBI 4300
RUEHGV/USMISSION GENEVA 0943
RHEHAAA/NSC WASHDC
RHMFISS/JOINT STAFF WASHDC
RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RHEFDIA/DIA WASHDC//DHO-7//
RUCPDOC/DEPT OF COMMERCE WASHDC
RUFOADA/JAC MOLESWORTH RAF MOLESWORTH UK//DOOC/ECMO/CC/DAO/DOB/DOI//
RUEPGBA/CDR USEUCOM INTEL VAIHINGEN GE//ECJ23-CH/ECJ5M//

C O N F I D E N T I A L SECTION 01 OF 04 HARARE 001118

SIPDIS

SIPDIS

AF/S FOR S. HILL
NSC FOR SENIOR AFRICA DIRECTOR B. PITTMAN
STATE PASS TO USAID FOR L.DOBBINS AND E.LOKEN
TREASURY FOR J. RALYEA AND T.RAND
COMMERCE FOR BECKY ERKUL
ADDIS ABABA FOR USAU
ADDIS ABABA FOR ACSS

E.O. 12958: DECL: 11/21/2017
TAGS: EFIN ECON PGOV AMGT ZI
SUBJECT: ZIMBABWE,S MULTIPLE EXCHANGE RATES,
HYPERINFLATION, AND A DEEPENING CASH CRISIS

REF: A. HARARE 1093
¶B. HARARE 1073
¶C. HARARE 1042
¶D. HARARE 0951
¶E. HARARE 712

Classified By: Pol/Econ Deputy Chief Frances Chisholm. Reason: 1.4 (d
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Summary

¶1. (SBU) Players in Zimbabwe's formal and informal economy primarily use three different exchange rates: a grossly overvalued official rate that is forced on exporters but a source of patronage for the ruling party in selling forex; a parallel rate for cash, which has become extremely scarce recently; and a second parallel exchange rate based on forex cash transactions and local-currency bank transfers. Various other exchange rates are used as benchmarks in accounting, in pricing goods, and by diplomatic missions and international NGOs.

¶2. (C) PriceWaterhouseCoopers (PWC) put the annual inflation rate in November at an average 126,000 percent, and it appears that disagreement between RBZ Governor and President Mugabe over how many zeros to lop off a new set of notes could be holding up their urgently needed release. The stalemate over new notes in hyperinflationary times is worsening the cash crisis and fuelling the steep fall in value of the local currency. Yet again, the GOZ's piecemeal and uncoordinated approach to policy reform is wrecking havoc on the economy. End Summary.

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A Stagnant Official Exchange Rate Under Hyperinflation(
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¶3. (SBU) There are three main exchange rates used in Zimbabwe's formal and informal economy. The first is the official rate of Z$30,000:US$1 - unchanged since September 2007 despite hyperinflation. Even with the option introduced by the Reserve Bank of Zimbabwe (RBZ) on October 1 (Ref D) for exporters to invest retained exchange proceeds in the RBZ's overnight window at a once-off return of 975 percent, the effective official exchange rate is still only Z$322,500:US$. Except for registered exporters who are required to surrender 35 percent of their export proceeds to the RBZ at the official rate as soon as they are paid, practically no one holding foreign currency uses the grossly overvalued official exchange rate to purchase local currency. On the other hand, selling foreign exchange to insiders at this distorted, highly favorable rate is a source of patronage for the ruling party.

Drives Forex Into The Illegal Cash Market(

¶4. (SBU) Holders of "free funds" (i.e. foreign exchange not generated by domestic production) commonly use the parallel cash market for exchanging hard currency at a rate that fluctuates daily depending on demand. It is, however, an illegal transaction. Since mid-January 2007, the Zimbabwe dollar has depreciated by 99.8 percent (from Z$2,800:US$ to

Z$1.6 million:US$) on the parallel cash market. The slide has temporarily stalled due to a dearth of Zimbabwe dollars on the market caused by a lack of supply of cash to the banks by the RBZ.

The More Favorable "RTGS Rate"

¶5. (SBU) A third increasingly-used but also illegal exchange rate involves completing foreign exchange transactions through bank transfers. An individual with free funds to sell converts his money by either paying the seller of local currency the hard currency in cash or via an off-shore transaction. In return, he receives a Zimbabwe dollar transfer into his local currency bank account. Both the seller and the buyer of foreign exchange must have local bank accounts denominated in local currency to enable the electronic transfer of funds under Zimbabwe,s Real Time Gross Settlement (RTGS) system. The exchange rate for these transactions is referred to as the RTGS rate. Until early this year, the RTGS rate was generally about 35 percent above the cash exchange rate, but in the last weeks it has soared to Z$5.2 million:US$1 (a 225 percent premium). Indications of closer scrutiny of bank transfers by the RBZ could, however, put a damper on this newly-burgeoning means of exchanging money.

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Cash Crisis Drives Parallel Exchange Rates Apart
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¶6. (SBU) One reason why the RTGS rate is more favorable than the cash market is the lag between selling foreign exchange and accessing the local currency either by writing a check, using a debit card, or, until recently, withdrawing cash: Under hyperinflation it is anticipated that the exchange rate will continue to depreciate as the transaction is processed and thus the buyer of the local currency gets a premium. Also contributing to the divergence in the two parallel market rates is the current extreme cash shortage (Refs A, B, C). The dearth of cash is driving individuals who trade in forex

to switch from the cash market to bank transfers. As a result, demand for cash transactions has softened and the rate of depreciation of the Zimbabwe dollar on the parallel cash market has slowed.

And Other Sundry Exchange Rates

¶7. (SBU) The Old Mutual Implied Rate (OMIR) is frequently used as a benchmark exchange rate by accounting firms and stock analysts. It is derived from the ratio of the Old Mutual share price on the Zimbabwe Stock Exchange to the price on the London Stock Exchange, and the cross exchange rate of sterling to the US dollar. On December 11 the OMIR was Z$4,302,000:US$.

¶8. (SBU) The parallel-market price of fuel has also served as a surrogate for the exchange rate in the cash market in recent years, with the fuel price reliably pegged at about ten percent below the US dollar cash rate. Lately, however, increases in the parallel-market price of fuel have outpaced the depreciation of the cash rate. On December 13, fuel cost Z$3 million/liter on the parallel market) nearly double the

US dollar exchange rate for cash.

¶9. (SBU) Embassy Harare currently uses a rate of Z$1.5 million/US$ for all official local currency transactions, including vendor payments and accommodation exchange. The State Department's Financial Services Center in Charleston procures Zimbabwe dollars at the best rate it can find on the international currency market from reputable dealers, and wires the money to the Embassy's local currency bank account at Standard Chartered Bank in Harare. This rate usually significantly lags the parallel rate, but due to the cash shortage which has brought down the parallel rate in the cash market, these rates are now about the same.

¶10. (SBU) Numerous international NGOs as well as some diplomatic missions use Global Currencies Ltd, a London-based company, to exchange foreign currency. Global Currencies' exchange rate before the current cash crisis was roughly 70 percent of the parallel market cash rate. Other international NGOs receive a similarly favorable exchange rate from local commercial banks with the apparent blessing of the RBZ (Ref E)

Inflation Shoots Above 100,000 Percent

¶11. (C) In the meantime, Manuel Lopes (protect), a senior executive at PriceWaterhouseCoopers (PWC), told us on December 10 that the company's monthly cost of living analysis for November put the annual rate of inflation for low, medium and high-income earners at 124,000 percent, 119,000 percent, and 136,000 percent respectively, and the monthly increase at 134 percent, 164 percent, and 150 percent respectively. (Note: Under pressure from the GOZ, PWC suspended publication and distribution of its monthly report in August 2007. End Note)

And Still No Rollout of New Notes

¶12. (C) Standard Chartered Bank Board member John Laurie told us on December 11 that Politburo contacts had informed him that the rollout of new notes had been delayed in large part due to disagreement over how many zeros to lop off the currency. RBZ Governor Gono was reportedly lobbying to drop six zeros, but President Mugabe favored slashing only three. Laurie's interpretation was that Gono favored the more radical move because he was not confident he could get

inflation under control before the value of dropping only three zeros erodes way, while Mugabe would lose face if he conceded to dropping six zeros.

Comment

¶13. (SBU) It is not surprising that the Zimbabwe dollar continues to depreciate on the parallel market given the high demand for foreign exchange as a hedge against hyperinflation, the evaporation of legally available forex, and the quickening pace of economic decline. Rather than dampening the parallel market by throttling the cash supply, Gono's misguided piecemeal policy measures have only accelerated depreciation of the local currency on the

parallel market for bank transfers. In the meantime, for lack of cash and goods in the shops, and due to hyperinflation, consumers and retailers alike have little joy this holiday season.
MCGEE